RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

SINCE 1958 •

POST OFFICE BOX 1759, LA JOLLA, CALIFORNIA 92038
26 LETTERS PER YEAR • $225 ANNUALLY

October 3, 1990 **LETTER 1053**

TELL-TALE ACTION: This is the first international crisis in which the dollar has declined instead of rising. Reason: the US is so debt-heavy that the risks to the dollar outweigh the advantage of political safety.

NOW WHAT? The battle lines are drawn. Hussein continues to build up his defenses, and his fanatic followers are saying they will starve or "eat dirt" before giving in to Mr. Bush's demands. Hussein's latest is that if we try to starve out his people, he'll blow up the Saudi oil fields and attack Israel (Hussein is dying to get Israel into the fray).

Meanwhile, time is running out for the Bush/Hussein stalemate. Iraq is simply running out of food. And the US military build-up is nearing completion. The GIs are hot, sand-logged, bored and asking when they can go home. The problem is to get rid of Hussein. The outcome -- probable war. The danger -- this war won't be any Panama or Grenada. Iraq has a huge army, good equipment and plenty of high-technology weapons, many of which were sold to them by the US right up to a few months ago. Current status: uncertainty, which everyone hates, including the stock market.

COVER-UP? As I see it, the Iraq situation is a cover-up for the real bear. Iraq gives optimists an out, an excuse to be temporarily bearish. But the real reasons for this bear market are far bigger than Saddam Hussein. And the real problems behind this bear market won't disappear as quickly or as easily as the Iraq/Hussein situation.

Want an example of the problems I'm talking about? Total Japanese real estate is valued at a ridiculous $20 trillion -- twice the valuation of all North American real estate. The Japanese real estate valuation is a BUBBLE, and bear markets burst bubbles. If Japan's real estate bubble bursts, the results could be ***50*** times worse than our own S&L disaster. It will have an unbelievable bearish effect on stock and bond markets throughout the world.

MARKET CAPSULE: On September 24 the D-J Industrial and Transportation Averages broke simultaneously below their August 23 lows. In doing so they reconfirmed the primary bear market.

My Primary Trend Index (PTI), having recorded its bull market high on January 3, has been plunging to new lows. The chart on page 2 tells the story. But the scariest part of the PTI situation is that the extraordinary "stilt formation" in the PTI has now broken down on my P&F chart (see page 2 chart). Where the PTI is headed I don't know, but I do know that it hasn't had a major correction for far too many years. Thus, the stilt formation with a complex top. With the top now crumbling it's an ominous situation, to say the least.

THE PICTURE: The experts are mystified. They don't understand why this market isn't in the midst of a rally. After all, public sentiment is bearish, the market has been oversold since early July, the news is rotten, odd-lot shorts have surged, short interest is at a record high, the Dow has already given up over 500 points, breadth has collapsed to the levels of 1985, and on every hand, the gurus and the Wall Street experts tell us that "stocks are now cheap." Moreover, these same experts are telling us that "the market is a buy because stocks have been declining for a year and the worst must surely be discounted by now."

Sept. 21 DJIA 2512.38; PTI 3202; A-D Ratio -15.82
Sept. 28 DJIA 2452.47; PTI 3194; A-D Ratio -17.05
Dow Yield: 4.14%; Dow P/E: 11.8; DowPow: -862
Dow Book Value: 1276; Dow 200-day MA: 2732
Percentage of Undervalued Blue-chips: 32%
PTI 89-day Moving Average: 3258

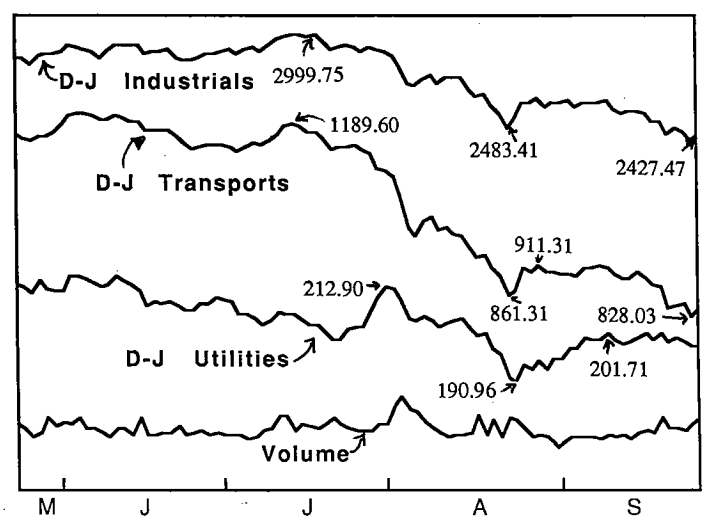
Unfortunately, the great majority of experts and gurus don't know how primary bear markets work. First, primary movements in bear markets don't run along bull market lines. Second, primary movements in bear markets (and bull markets, for that matter) can go to shocking extremes.

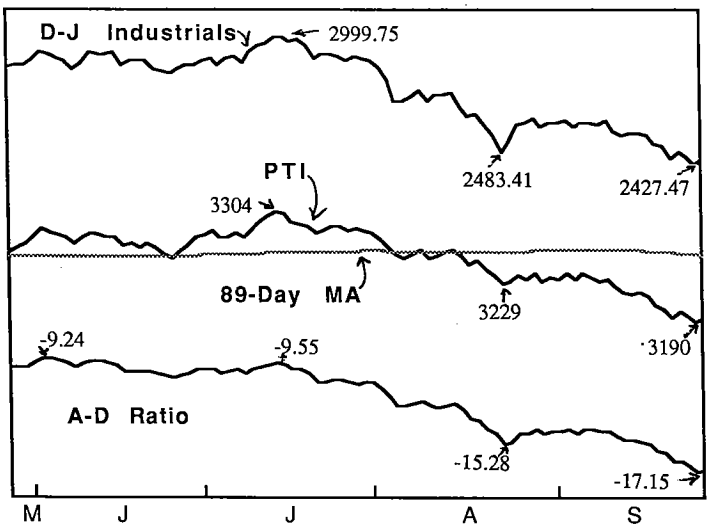
How far can a primary movement carry? A basic premise of Dow Theory is that neither the duration nor the extent of a primary movement can be predicted in advance. However, my own observation is that big bull and bear markets have a tendency to carry farther than anyone thinks possible at the time.

There are, of course, some fundamental observations one can make about primary bear markets, and probably the most important one is this -- big primary bear markets ultimately take stocks down to a level where they represent great values. What is a "great value?"

The classic, reliable measure of a great value is a very high return on the investment. Let me put it another way -- almost every major bear market has taken equities down to the point where investment-grade stocks yield 6% or more on average. Traditionally, we use the Dow as a measure of investment-grade stocks. Based on the current Dow dividend of $101.08, the Dow would have to drop to 1685 in order to yield 6%. In 1982, the yield on the Dow got to almost 7%. If the Dow were to approximate its 1982 valuation level, it would sink to 1444 (but I've said so many times before, dividends are invariably CUT during a bear market).

On page 2, I have included a chart (courtesy of *Ned Davis Research*) which traces the Dow all the way back to 1915 along with the Dow's price-to-dividend ratio. Currently, the Dow is selling at around 23 times its dividends, far above its "bear market bargain" level of 10-16 times dividends. So is the Dow cheap, are investment-grade stocks a bargain? Hardly.





Another point I want to make is that bad news invariably emerges during a bear market just as good news always surfaces during a bull market. But bad news affects a bear market DIFFERENTLY than it does a bull market. In a bull market when the major trend is up, bad news often triggers a market rally (the rationale being that bad news during a bull market presents an opportunity for bargain-buying). But in a bear market bad news tends to drive stocks lower. If you don't believe this, check my historical chart book with the noted events during 1973-74 or during 1929-32.

It is in the nature of this business that we don't deal with sure things. Unfortunately, we deal only with probabilities. And yes, the probabilities, based on historic technical studies, have favored a market rally, an upward correction of some of the drastic damage that this bear market has wreaked on stocks so far.

But the market is a law unto itself, and as I've written a hundred times -- the stock market will do whatever it has to do to make life uncomfortable (or unbearable) for the GREATEST number of traders and investors.

Therefore, with the public and the institutions still owners of massive amounts of stock, with all the gurus insisting that the market "should" rally based on past history and past performance -- why shouldn't this bear market do the unthinkable? Of course, the unthinkable would be to continue to go down.

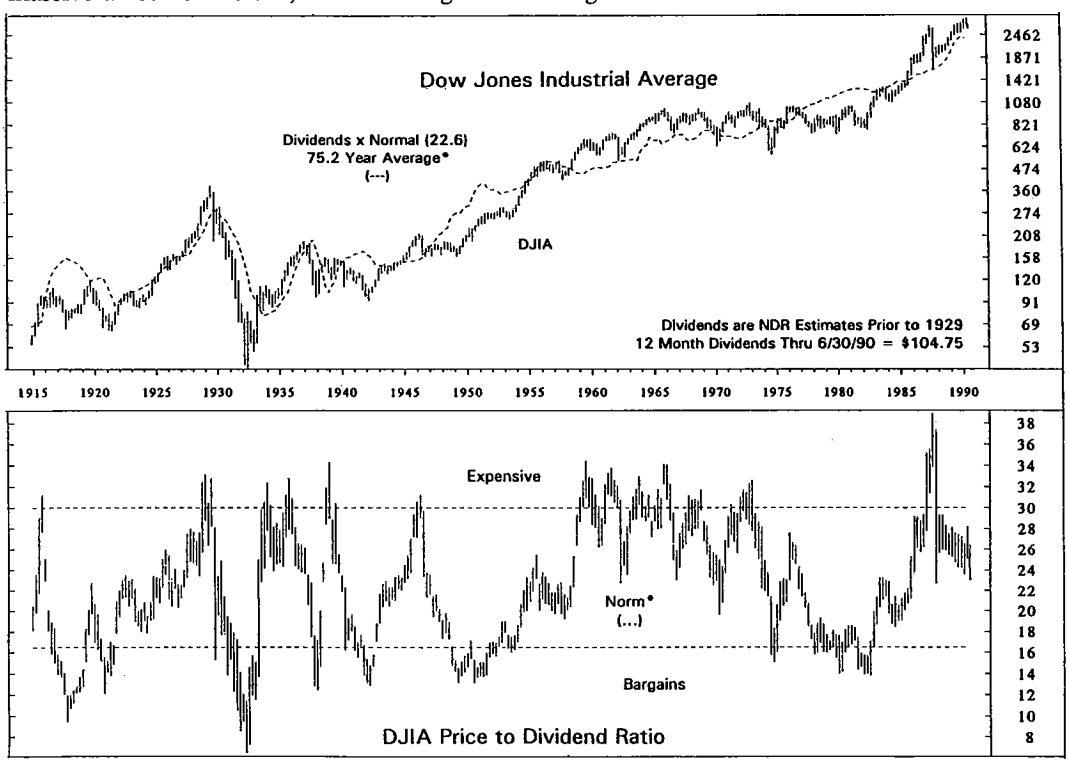
Mind you, I'm not saying that the market isn't overdue to correct. I'm not saying that all these oversold indications (in due time) won't set off an impressive rally. What I am saying is that the long-awaited rally doesn't have to occur now, just because this bear market is severely oversold. Just as bull markets can stay overbought, so bear markets can stay oversold. That's the thought I want to get over to my subscribers.

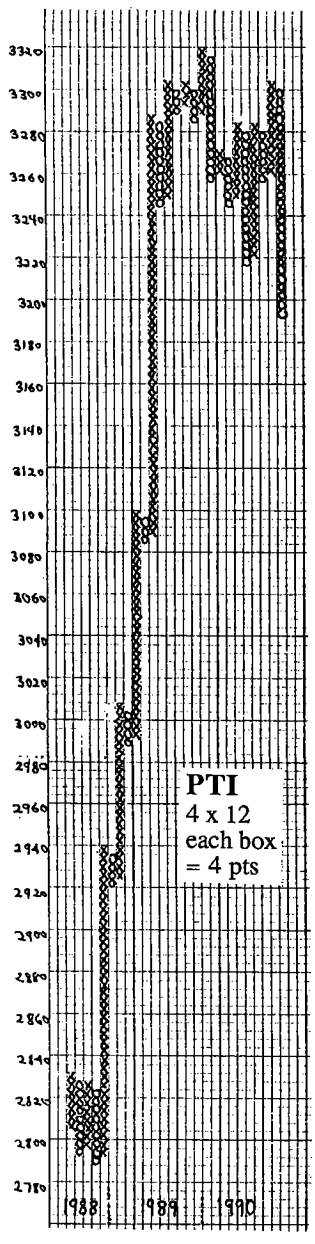
FOREIGN: Yesterday I spent most of my waking hours going through two big chart books published by David Fuller -- the European Point & Figure Library and the International Point & Figure Library (*Chart Analysis Ltd.*, 7 Swallow St., London WIR 7HD). The two books cover hundreds of stocks on every exchange from Australia, Canada, Singapore/Malaysia to Britain, France, Germany, Norway, and Spain, and many others.

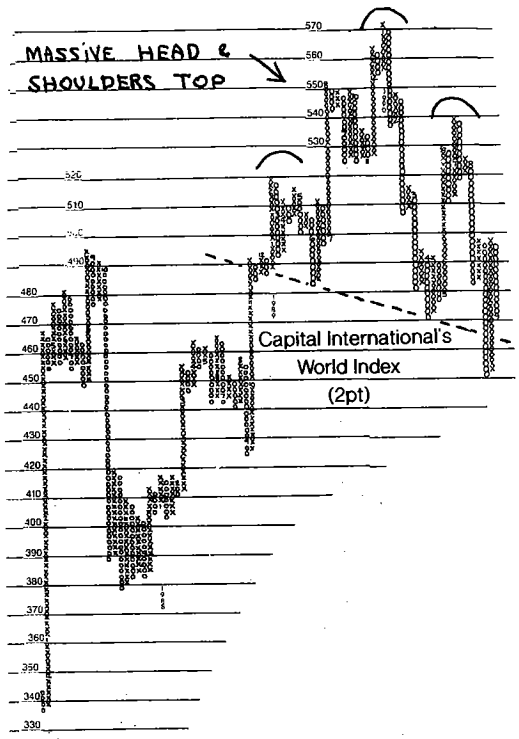
I wish every one of my subscribers could see these charts. Believe me, they were eye-openers. On every hand I saw head-and-shoulders tops, collapses, dramatic declines, equities from every nation tumbling to new lows. Particularly ominous was the across-the-board smash in Japanese stocks. Page after page of collapses offered mute testimony to the staggering losses on the Tokyo exchange.

Conclusion: This is absolutely a global bear market. No nation is escaping the wrath of the bear. Furthermore, these myriad stock collapses are telling me that we can expect a world recession (or depression), and it is not something we can blame on Saddam Hussein. These international stocks started topping out many months ago.

I am including here (courtesy of *Chart Analysis Ltd.*) a P&F chart of Capital International's







World Index, a composite of all the world's stock market indices. The chart covers the last three years of action going back to 1987. Here we see that a massive head-and-shoulders top pattern has formed. I have drawn in (dashed line) the bearishly down-slanting neckline (support line). Note this line has recently been broken. This index suggests that stocks across the globe will remain in the grip of the bear.

For that matter, many US stocks have suffered massive (and I mean MASSIVE) collapses, and I don't think most people realize the extent of the losses. Just to name a few well-known US stocks that have sustained major losses -- Dow Chemical, Union Carbide, Raytheon, Unisys, Texas Instruments, Xerox, Zenith, Goodyear, Northrop, McDonnell Douglas, Lockheed, Citicorp, Chase Manhattan, JP Morgan, Dow Jones, NY Times, Boise Cascade, Time-Warner, UAL, K-Mart, Sears, JC Penney, Marriott, Allied Signal, Navistar, and on and on and on.

TWO INTERESTING ITEMS: Item 1: Insiders: The following is from the lastest issue of the very informative *Market Logic* advisory: " 'Insider indicator' -- Extremely favorable. During the last 30 days, 78% of insiders making open-market trades in their company's stocks were buyers. 35% is normal."

Russell comment: The fact is that corporate insiders have been buying heavily for many months, and this phenomenon has been advanced as a reason "why the market must turn up and why a dramatic advance is in the cards."

Insider buying is bullish during a bull market, when the underlying long-term trend of the market is up. But corporate insiders know little or nothing about the workings of the stock market or the direction of the primary trend. Consequently, in a bear market, insider buying is like so much chaff in the wind.

Let me put it another way: a given insider may know everything about the workings of his own company, but he knows little or nothing about a much larger force, the primary trend of the market. Thus, during a bear market a given company may actually increase its earnings. But during a bear market price/earnings ratios go down, and that phenomenon takes the prices of almost all stocks to lower levels. Thus for the most part, insiders buying their own stocks have been killed in the bear market so far.

Item 2: A speculators' best friend is his margin account. As a primary bull market advances and speculators become more enthusiastic, margin borrowing on the NYSE tends to rise. During a bear market the exact opposite holds true. In other words, margin totals tend to rise and fall with the primary trend of the market. The latest August figures show that margin debt on the NYSE dropped a big $1.8 billion in August -- to $30.3 billion, the lowest level since March 1986. What's happening is that the bear market is beating the speculators to death, and as they are knocked out of the market, their margin accounts are closed down.

Conclusion: This big bear market is decimating the insiders and the speculators as well as the public.

INVESTMENT POSITION: I'm getting calls from subscribers, friends of subscribers, friends of friends, people who have heard me on my weekly interviews on FNN or LA's Channel 22. The calls run like this: "I'm losing a ton of money, and I don't know what to do," or "I should have taken you seriously, and is it too late now to sell?" or "My broker has killed me, and I should have listened to you, but . . . ."

I generally tell people the following: This is a bear market. Nobody (and I include myself) on the face of this green earth knows when it will end, or at what level it will end, or whether it will rally late today, next week or next month.

In my own account, I follow correct Dow Theory principles in investing. That means being out of stocks and in a liquid position during bear markets, and committed heavily to stocks during bull markets. This being a bear market, I'm out and on the sidelines, and I suggest you do the same. Forget your wishes and hopes, forget what your broker or your neighbor or your local newspaper guru tells you, the correct place to be is out of stocks and safe on the sidelines. That's what I call the "happy-sleep position," meaning that if you're out and on the sidelines you're going to sleep well.

About 90% of what you read in the papers or in the advisories or what you hear on TV has to do with what stocks look cheap or what stocks to buy. Nobody wants to hear about bear market losses or correct procedure or being on the sidelines in cash. This is what I term the "perma-bull" attitude. It's ingrained in the minds of many so-called Wall Street experts, and it's a way of life for most of the brokerage houses.

Bullishness is great and it's definitely warranted during a bull market. But bullishness and optimism can be very costly during a bear market. Being out of stocks and trying to jump in at the beginning of the next upside correction is a frustrating, hair-pulling pastime. Here's the other side of the coin -- holding stocks and hoping for the end of a bear market down-leg is frustrating and frightening -- and it can break you financially.

So my advice is forget the clever timing. Forget waiting to sell "on the next rally." Forget trying to outwit the bear. Correct procedure says, "When the bear is in charge, get out of equities and stay liquid on the sidelines." The bear wants to take the market down with as many investors as possible aboard. In other words, the bear loves a full elevator when he presses the down-button.

DOW and the MOVING AVERAGES: Moving averages (MAs) constitute one of the oldest and most useful areas of technical analysis. Every analyst I've ever met seems to have his own favorite brand of moving average. Some use simple moving averages, others use front-weighted moving averages, while still others use exponential mean moving averages. Length of MAs vary with the analysts, some preferring 13-day or 55-day and others preferring monthly or -- well, the variations are endless.

The simple 200-day moving average of the Dow is probably the one that most analysts follow (certainly it's the granddaddy of all MAs). George Schaefer, the late, great Dow Theorist (he wrote his

marvelous report from 1949 to '74), accorded great importance to the 200-day MA. In fact, Schaefer termed the 200-day MA of the Dow the "Investment Line."

Schaefer reasoned as follows. The Dow consists of 30 large, widely-followed blue-chip stocks. These 30 stocks are typical of the kind of shares that seasoned investors buy. Buying and selling by large investment interests sets the trend of the market. It therefore follows that the action and direction of the Dow tells us a great deal about the major trend of the market and what big investment money is doing.

When the Dow sells above its long-term or 200-day MA, this means that large investors are willing to buy good stocks at prices that are higher than they were on the average of the last 200 days. That, on the face of it, is bullish. The converse is true when the Dow sells below its 200-day MA. In a bull market the Dow (except for occasional secondary reactions) tends to stay above its 200-day MA, and the converse is true during a bear market.

To give you a little background, on August 9, 1952, Schaefer wrote: "I have always maintained that the 200-day Investment Line is one of the most valuable tools in the forecasting business. Any man who will make it his job to learn everything there is to know about the 200-day Investment Line and its relationship to the D-J Industrial Average will find himself in possession of knowledge that, in all likelihood, will help him to make money in stocks throughout his entire investment lifetime."

On September 20, 1952, Schaefer wrote: "In considering our studies of the Dow and the Investment Line, it is important to remember that the higher the market goes, the less valid the situation becomes. Some day, the Dow will go below the Investment Line and stay there. Then both the Dow and the Investment Line will turn down, in what will be the beginning of a new bear market."

Russell comments: I have always followed the action of the Dow in relation to its 200-day MA, even though I don't often write about the MA (note, however, that the 200-day MA figures are included at the top of page 1 in each Letter).

In my studies of the primary trend I use a number of different moving averages, but the study that has proved most valuable to me is the 200-day MA of the Dow combined with the more sensitive 30-day MA of the Dow.

Using the 30-day and the 200-day MAs together, the formula for the major bullish mode is as follows: The Dow is above its rising 30-day MA, and in turn the 30-day MA is above its rising 200-day MA. The formula for the major bearish mode is as follows: The Dow is below its declining 30-day MA, while the 30-day MA in turn is below the declining 200-day MA.

In other words, the juxtaposition of the Dow with its shorter-term and longer-term MAs can tell us a lot about the sentiment, thinking and acting of large investment interests. And never forget that it is the large, seasoned investors who set the trend of the market.

All right, what are the Dow and its MAs saying now? The 200-day MA of the Dow has turned down (it currently stands at 2744), and is now declining at the rate of around a point a day.

The shorter-term 30-day MA turned down in early August. **On August 30, the 30-day MA plunged below the 200-day MA.** The 30-day MA is declining at the rate of 10 points a day and now stands at 2675.

Conclusion: With the Dow below its 30-day MA and the 30-day MA below the 200-day MA, the dual moving averages study is now in the **bearish mode.** On any rally from here, the Dow should encounter resistance at the 2660-75 area and further major resistance at the 2744 level (the current levels of its MAs).

NOTES and QUOTES: The current era will be known as the "beginning of the end of the age of oil." From here on developed nations will opt increasingly to be energy-independent. The most obvious alternatives to oil in the US will be coal and natural gas (natural gas is more plentiful than oil and more evenly distributed geographically). Last year production of oil in the US dropped 6%. It is believed that no more undiscovered major pools of oil exist in the US. Amazing fact: The average oil well in the US produces 15 barrels of oil a day. The average oil well in Saudi Arabia produces 9,000 barrels of oil per day.

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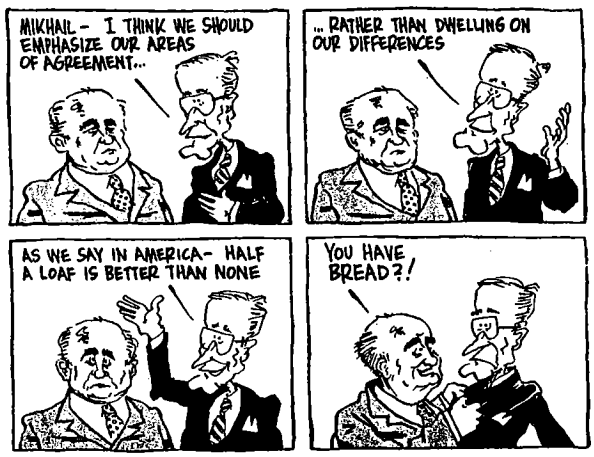
The breadlines in Moscow have run out of bread, and great cartoonist Dan Wasserman offers this comment.


MIKHAIL - I THINK WE SHOULD EMPHASIZE OUR AREAS OF AGREEMENT...
... RATHER THAN DWELLING ON OUR DIFFERENCES
AS WE SAY IN AMERICA- HALF A LOAF IS BETTER THAN NONE
YOU HAVE BREAD?!

* *

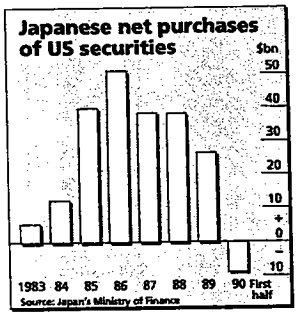
The Gorbachev era is about over. So is the Soviet Empire. Now it is just Russia and a collection of bickering states. Gorbachev, the man who presided over the collapse of Communism, was ahead of the times for many years, but of late, sad to say, Gorby has fallen behind the times. Gorby tried to save Communism through perestroika. He tried for five years. It never worked. Communism with the addition of a portion of perestroika is like a women who is a little bit pregnant. She either is or she ain't. Russia is going to have to go the whole way to free enterprise, or it's going to be breadlines ad infinitum -- or revolution. Today, anything even hinting of Communism is hated in Russia.

America was convinced that its interests lay in a perestroika/glasnost hodge-podge brand of Communism with Gorbachev as its guru. As usual, we picked the wrong horse. Current problem for the Administration -- picking the new Russian leader. At this point, the whole thing is up for grabs and it's anyone's guess who'll be running what some people still laughingly call "The Soviet Empire."

* *

The Administration and Congress (I've often said this) have no strategies -- they merely react to crises. But they have made two massive mistakes: (1) becoming far too dependent on foreign oil, and (2) becoming far too dependent on foreign capital to finance the absurd and disastrous US deficits (of course, the deficits themselves could be considered a third massive mistake).

A world liquidity squeeze is on. Every nation needs dollars or francs or marks or pounds or some form of money. The US, over its head in debt, needs liquidity badly. Up to now, much of the US liquidity came from overseas -- via Japan and Germany (two major exporters of cash and two major buyers of US debt and goods). But both of these sources have pretty much dried up. Germany needs its money to revive and rebuild East Germany. Japan needs its money to hold up its shrinking economy. In fact, Japan wants some of its money back, and this chart (courtesy of *The Economist*) shows that after a decade of heavy spending in the US, the situation is now reversed. According to the Japanese Ministry of Finance, in the first six months of 1990 Japanese investors pulled $8.9 billion OUT of the US stock and bond markets.



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In the face of the crunch, Mr. Bush and the boys have been pressuring poor Fed Chairman Greenspan to lower interest rates. But the world's finance ministers at G-7 are committed to fighting inflation with steady to higher interest rates. If the US lowers its rates (even assuming that they can do it) the dollar will become less attractive and it will be harder than ever to attract capital to the US. Is Greenspan sorry that he ever took the job? You ask him.

* *

The FDIC (which insures the nation's banks) reports that the banking industry now holds $27.7 billion in real estate loans that are 90 days or more past due. That's 13% ahead of last March and double the amount registered at the end of 1986. The worst problems are occurring in New England where FDIC Chairman Seidman states, "In the areas where we're having the real problems, things have gotten worse."

* *

In 1982 all of the following major banks were rated AAA or AA+ by Standard & Poor's -- BankAmerica, Chase, Chemical, Citicorp, Man. Hanover, JP Morgan, Security Pacific. since then every one except Morgan has been downgraded. Morgan is now the only major bank still boasting a AAA rating.

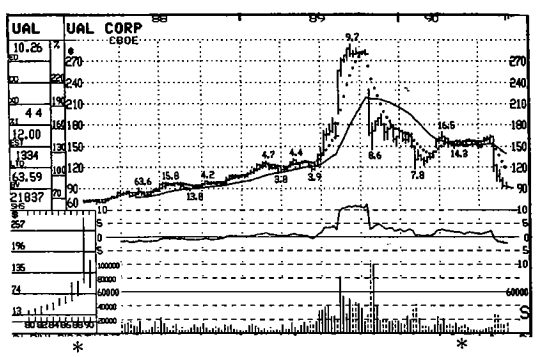
Meanwhile, the news from the S&L industry is so bad that they have shot the messenger. The Office of Thrift Supervision has announced that they will cease providing any press releases tallying up the monthly change in total deposits and assets of the nation's S&Ls.

* *

Question: Why do bizarre aliens from outer space avoid NYC?
Answer: Because last time they were there a few wise guys snapped off their antennas.

* *

Study this chart. It's UAL, the airline that has, according to the *WSJ*, cost arbitragers, speculators, traders and investors over $1 billion in losses. The union has been bickering over the UAL takeover deal for almost two years, and the stock is periodically boomed and bombed with deals, new deals, and assorted rumors. Takeover artists call it "the Deal from Hell." Said one trader, "The stock is like being in a love-hate relationship. When I buy it, I can't sleep. When I sell it, I feel great." From a high of 296 in September 1989, UAL dropped to 89.50, then rallied into the 90s. I include this piece because UAL is one of the THE items that has added so much volatility to the D-J Transportation Average.



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I have a new variation on meditation. I turn on TV Channel 22 out of LA, which runs a continuous tape of both the NYSE and the AMEX. Then I mute the TV sound and put on a disc of 1940s jazz (Coleman Hawkins or Red Norvo are my preferences, particularly on slow, dreamy numbers). Next, I sit back and relax. The mind wanders. Ideas and concepts are conjured up. The present blends with the past. Am I in La Jolla in 1990 or on 52nd Street in NYC in 1942? Is the Dow at 2500 or 125? Don't tell me, I'm thinking, I'm relaxing, I'm spanning the decades, I'm in Alpha.

* *

Thank you Mark Hulbert for the write-up in the current issue of *Forbes*. But did you have to call me a graybeard? I used to have a Fu Manchu mustache (I tried that back in the '60s, but I had to give it up because my kids didn't recognize me) -- but I never had a beard.

* *

You know, the unspoken secret in the letter-writing business is that most of the publishers are a bit daffy -- they don't have both oars in the water. I've never figured out whether you have to be looney to go into the business or whether the business makes you looney. I've been watching the tape for 45 years, and I've been publishing since 1958. Therefore, I figure I'm entitled to be a bit zany. But I'll stay generally sane, that's a promise.

* *

Reality has changed the tune for the nation's market men and women. Two weeks ago *Mansfield Chart Service* surveyed 31 market seers. By a count of three to one, the experts thought a recession had already started or would be in place by the middle of next year.

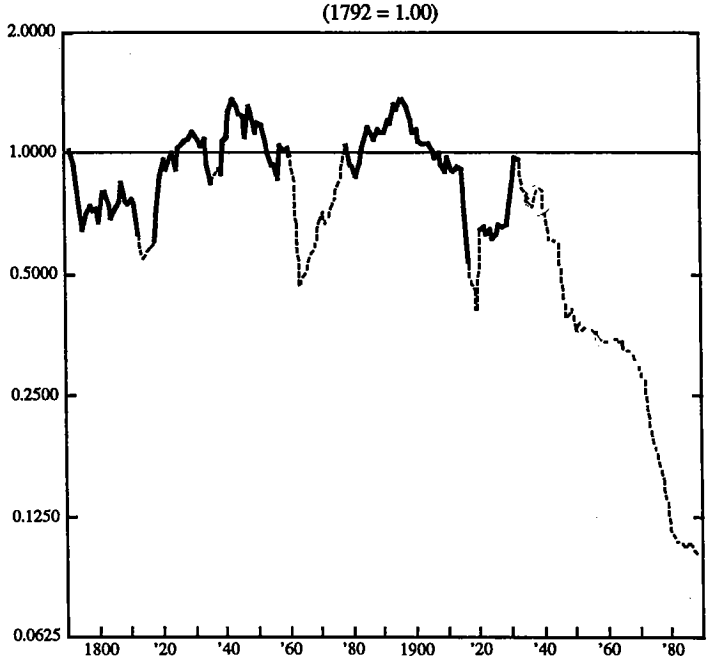
* *

During WW II my squadron was entertained by comedian Red Skelton. Incredibly, Skelton is still at it, still making people laugh. Recently Red's doctor examined him and told him "Red, you're as sound as a dollar." Said Skelton, "That scared the hell out of me."

* *

The *American Institute for Economic Research*, Great Barrington, Mass. 01230, put out this tell-tale chart, and it's a chart well worth studying. The chart traces the purchasing power of the dollar from 1800 to the present. The solid portion shows periods when the dollar was redeemable into monetary commodities (gold or silver), and the dashed portion shows periods when redeemability into gold or silver was impaired (1918-19 and 1933 to '71) or suspended (1814-17, 1837-38, 1872-76 and 1971 to present).

PURCHASING POWER OF THE DOLLAR
(1792 = 1.00)



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In his excellent Sept. 13 report, Joe Granville talks about program trading. He says, "I love it and I hope it is never abandoned. Without it the daily market would be very boring. If one is right on the market, that is what counts. Once one is right on the market, the program trading exacerbates the profits." Then he points out that nobody complains about program trading during a bull move.

And you know -- I agree with Joe. Frankly, I don't give a damn whether the big boys program trade or not. The fact is, nobody can reverse the primary trend. If you're right on the main trend, who cares (unless you're a day-trader) what the big boys do. Let them mess with the market. The primary trend is what makes you money (in a bull market) or saves your skin (when you're out during a bear market). Morgan Stanley, Salomon Brothers -- be Joe's and my guest, do all the program trading you want. And if you can make any money in this bear market, go for it.

* *

Back in 1942 when I was at Rutgers University, I used to have breakfast and lunch at the local diner, which was actually a railroad car, parked, dressed up and turned into a restaurant. Breakfast ran about 30¢ and lunch was about 45¢. The food was pretty good, and there was always good music on the juke box. It was an idea that wouldn't die. Now McDonalds is testing a 1950s style diner under the name Golden Arch Cafe. Their first test diner will open in Hartsville, Tenn. I wonder what they'll charge for breakfast?

* *

When the dollar is weak (as it has been), it is usually inflationary since it takes more dollars to buy items. But lately the dollar has been weak and so have commodities. What does this mean? It means that the value of commodities are falling at an even faster rate than the international value of the dollar. This implies a growing international liquidity problem. The demand for commodities remains high, that's not the problem. The problem is the means for payment for those commodities. For many nations that import much of their food needs, the money just isn't there.

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In 1968, when Paul Ehrlich's first warning, The Population Bomb, was published, the world population was 3.5 billion. In 1974, when Ehrlich's The End of Affluence was published, the world population had increased to 4 billion. This year, as Ehrlich's Population Explosion is published, the world's population has boomed to 5.3 billion. Today the world population is growing at the rate of 95 million a year -- this is equal to the combined populations of the UK, Ireland, Iceland, Belgium, Norway, Finland, Sweden and Denmark. Says MacArthur Fellow Ehrlich: If this continues we can expect that "more frequent droughts, more damaged crops and famines, more dying forests, more smog, more international conflicts, more epidemics, more gridlock, more drugs, more crime, more sewage swimming, and other extreme unpleasantness will mark our course. It is a route already traveled by our less fortunate human beings." Russell comment: Whew, is this what the developing bear market is all about?

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Market: One tragic facet of this bear market is that it has gone down with so few people having sold. The market loves to set traps. The "set up" was the crash of 1987 and the subsequent recovery to new highs -- then the mini-crash of 1989 followed by another new record Dow high. After that the word was, "The market always recovers, regardless of temporary trouble. Holding on to your stocks is the road to riches. You never sell good stocks." Thus, there were few sellers as this bear market plunged to lower levels (the broad Value Line Composite lost almost 30%). The funds and institutions sat and watched the decline while insiders bought their heads off. Remember, a company can have 100 million shares of stocks outstanding, but a 100 share transaction on the exchange sets the price for all those 100 million outstanding shares.

GOLD: Is gold sold out? I think it is. This is from a daily report I received last week from *M.J. Capital* of Great Neck, NY (a commodity firm that both trades and publishes an advisory). "Do you want to know the most interesting aspect to yesterday's trading in the precious metals? We could not convince our clients to buy gold or silver futures. Most of them were afraid, disgusted and disillusioned with the precious metals, and all handed us the excuse that just when they get aboard, the Russians will come in and sell the market to a pulp."

There's no question about it. People are turned off on the precious metals. And that's exactly the sentiment you need if you're going to get a bull market going in gold -- or any other item.

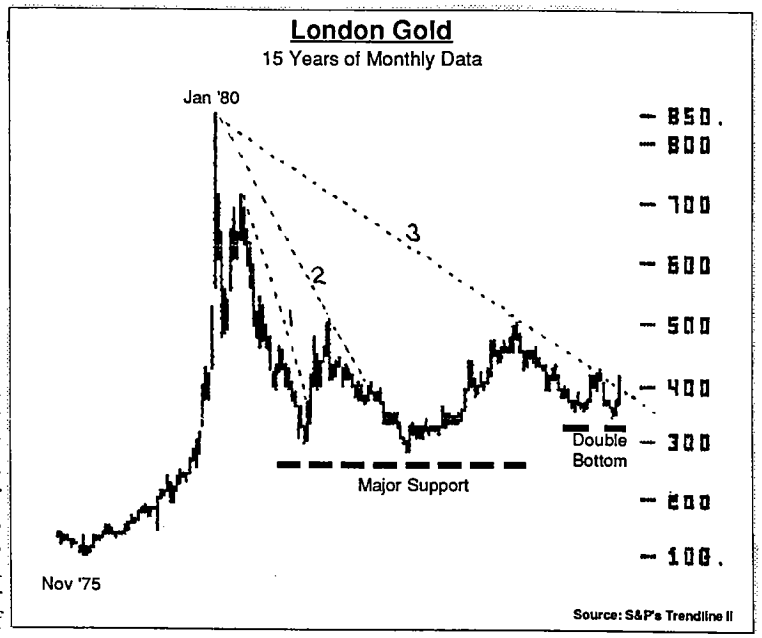
This is a monthly chart showing gold going back to 1975, and I think the chart is particularly interesting at this juncture. I have drawn three "fan-lines" on the chart. The theory of fan-lines is that when the third fan-line is intersected by the price movement, a major turn has been signaled.

Gold has now pushed up through the third fan-line on the chart, and my feeling is that gold has reversed to the bull side. A confirmation of this would be spot gold rallying above its last peak at 425, and a total breakout and major bull signal would be a gold advance above the double peaks at 500.

People are asking me whether gold is going up as a hedge against inflation, and if so do I really believe there is going to be any inflation? My answer is that neither I nor any one else knows whether there will be important inflation in 1991 and beyond. My guess is that gold is rising because informed investors are diversifying out of currencies and into "real money." People are worried about the banking system, people are worried about US debt, people are worried period. And when people are worried, they buy gold.

I've been buying gold because we're in a bear market, and when the bear is in charge events tend to turn out bad. Good things happen in bull markets and rotten things happen in bear markets. When rotten things occur, history tells us that we should opt for safety. Ultimate money is ultimate safety and ultimate money is gold.

Institutions can go bankrupt, stocks can go belly up, currencies can become museum pieces, governments can fall -- but gold is gold is gold. There's no way gold can go bankrupt because gold has no liabilities against it. That, in my way of thinking, is why gold has been rising.



LATE NOTES: Well, our Congressional negotiators finally came up with something. The package contained the expected hodge-podge of sin taxes and gas/oil taxes plus assorted budget cuts. It's a 50/50 chance that Congress will pass it. My guess is that the package (if it passes) won't make more than a dent in the deficits.

Hussein is talking, "Let's make a deal"; Wall Street is starving and tired of watching prices going down. The short seller, pessimists and bears have grown confident. When a bear market send stocks down too far, too fast and too persistently, pressure builds up in the market boiler. That's when the safety-valve goes off. It's called a bear market rally.

NEXT MAILING: October 17